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RUEHBU/AMEMBASSY BUENOS AIRES 1673
RUEHBY/AMEMBASSY CANBERRA 1820
RUEHJA/AMEMBASSY JAKARTA 0706
RUEHME/AMEMBASSY MEXICO 0530
RUEHNE/AMEMBASSY NEW DELHI 1290
RUEHOT/AMEMBASSY OTTAWA 2302
RUEHSA/AMEMBASSY PRETORIA 1728
RUEHRH/AMEMBASSY RIYADH 0449
RUEHUL/AMEMBASSY SEOUL 1659
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TAGS: EINV EFIN ECON PREL FR
SUBJECT: THE CRISIS AND FRANCE'S BANKING SECTOR

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¶1. (SBU) SUMMARY: French banks have remained generally profitable, despite almost USD 20 billion in subprime write-downs and credit losses. The government has provided banks with capital injections and guarantees on credit financing to bolster market confidence and encourage interbank and money markets to operate normally. It intervened swiftly, in conjunction with Belgian authorities, to rescue the Belgian-French bank Dexia with a combined 6.4 billion euro capital injection in late September. More recently, it has worked to prevent potential solvency difficulties for two large mutual banks, Caisse d'Epargne and Banque Populaire, by facilitating their merger with multibillion euro capital injection. Although France has some 400 banks, the sector is dominated by less than ten banking groups. END SUMMARY.

Bank "Rescue" Measures Largely Preventive

¶2. (U) In October 2008 the GOF took measures aimed at bolstering market confidence and encouraging the interbank and money markets to operate normally. A 360 billion euro bank rescue plan provided 320 billion euros to improve bank liquidity for lending and 40 billion euros to improve bank reserve positions via two special entities, the Corporation for Financing of the French Economy ("Societe de Financement de l'Economie Francaise - SFEF") and the Corporation for State Investment ("Societe de Prise de Position de l'Etat - SPPE"). In 2008, the government drew on these vehicles to inject 10.5 billion euros of quasi-capital in six banks (BNP Paribas, Societe Generale, Credit Agricole, Caisse d'Epargne, Credit Mutuel and Banque Populaire). The government will inject a second 10.5 billion euro tranche in 2009. Bank chief executives agreed to forego 2008 bonuses and dividends, as a percentage of profits were also reduced. The six banks have also pledged to increase lending between 3% or 4% annually, as stipulated in conditionality attached to the initial liquidity injections guaranteed by the GOF through the SFEF (Ref A). Only the Belgian-French group Dexia has required a "rescue," which the French and Belgian authorities conducted jointly in late September.

French Banks in Relatively Good Health

¶3. (U) Despite some USD 20 billion in subprime-related write-downs and credit losses, most large French banks posted net profits in

2008, and reinforced their capital funds, increasing core Tier 1 capital ratio above the 8% required level. However, analysts fear that higher credit risk and lower credit demand may affect this year's bank results. Depressed Eastern European economies are not likely to have a major impact on the French banking sector. With the exception of Societe Generale, French banks have a relatively low exposure to that zone. According to Bank of France statistics, French banks had 49 billion euros in outstanding loans to East European clients at the beginning of 2008, which was just 3% of their transborder loan portfolio.

¶4. (U) BNP, the largest bank, posted a 3 billion euro net profit in 2008 compared with record profits of 11.1 billion euros in 2007. The bank offset 5.7 billion euros in write-downs and in counterparty defaults in financial markets by cutting operating costs and reducing bonuses. Despite the recession in Ukraine, BNP Paribas plans to keep its 51% stake in UkrSibbank, the third largest Ukrainian bank. Exposure to Eastern European countries accounted for 1.8% of loan commitments in 2008, a situation that the bank deems manageable.

¶5. (U) Societe Generale, currently France's second largest bank, posted a 2 billion euro net profit in 2008 including an 87 million euro net profit in the fourth quarter despite the financial crisis and the first impacts of the recession. The results represented a rebound from a 3.3 billion euro loss a year earlier when the bank was hit by a 4.9 billion euro trading loss blamed on rogue deals by former trader Jerome Kerviel. Since October 2008, Societe Generale has had to triple its reserves to cover credit risk, particularly in Eastern European countries where it earns 11% of pre-tax profits. The bank's Tier-1 capital ratio of 8.8% gives it a solid capital

position. But it nevertheless has launched plans to solidify its position by combining its asset management unit with that of Credit Agricole and by reorganizing its corporate/investment banking unit.

¶6. (U)In a government-brokered move the mutual banks Caisse d'Epargne and Banque Populaire will merge into a single group, effective summer 2009. The GOF which will inject up to 5 billion euros into the group, in a mixture of super-subordinate debt and convertible preferred stock, giving it a 20% stake in the new bank. The investment bank Natixis, in which the two mutual banks each hold a 35% interest, posted 2.8 billion euros in losses in 2008, causing concomitant losses for the two parent banks. In 2008, Caisse d'Epargne posted a 2 billion euro net loss, and Banque Populaire announced a 468 million euro net loss. The government has named President Sarkozy's chief economic advisor, Francois Perol, to become the new group's CEO. The merger will create the second largest bank in France with a network of 7,700 branches and 619 billion euros in savings and deposits.

¶7. (U) Belgian-French Dexia, the world leader in lending to local governments, posted a 3.3 billion euro loss for 2008, in part driven by exposure to the U.S. real estate market and related securities. Its 6.4 billion euro bailout by the French and Belgian governments in late September gave the two governments effective control of the bank (over 50% of equity). Among the streamlining measures has been the elimination of Dexia's 900-person in-house trading unit. Dexia's core credit business with both individual and municipal borrowers has contracted significantly since the beginning of 2009. It has moved to anticipate possible losses in Turkey, the emerging market where Dexia is most exposed. Nevertheless, Dexia's Denizbank subsidiary there turned a steady 160 million euro profit in 2008. Dexia's Tier 1 capital ratio was 10.6% at the end of the year and the group had no difficulty with a 3 billion euro issue of two-year bonds in February.

Banking and Financial Market Supervision

¶8. (SBU) By summer 2009, the government plans to launch a reform of the financial supervision system including a merger of prudential supervision currently shared by the Banking Commission and the insurance regulator (Autorite de Controle des Assurances et des Mutuelles- ACAM). This reflects heavy involvement of banks in the

insurance business and aims to further strengthen the French financial system. In the mean time, the Banking Commission, housed within the French central bank, is also pushing hard within the European Union for a more uniform definition of Tier 1 capital, which the French supervisors feel is too varied. The reform is also to put the securities regulator (Autorite des Marches Financiers - AMF) in charge of overseeing disclosure and consumer protections for all financial products including savings, mutual funds, full life policies etc. to ensure comparability of information. The AMF has already begun a public consultation on risk disclosure and transparency for financial products.

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